



Tennessee Valley Authority

Fiscal Year 2007 Rate Review

TVA Board Meeting

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Forward-Looking Statements

This document contains forward-looking statements relating to future events and future performance. Any statements regarding expectations, beliefs, plans, projections, estimates, objectives, intentions, assumptions or otherwise relating to future events or performance may be forward-looking. In certain cases, forward-looking statements can be identified by the use of the words such as "may," "will," "should," "expect," "anticipate," "believe," "intend," "project," "plan," "predict," "assume," "estimate," "objective," "possible," "potential," or other similar expressions.

Some examples of forward-looking statements include statements regarding TVA's projections of future power and energy requirements; future costs related to environmental compliance; impacts of potential legislation on TVA and the likelihood of enactment of such legislation; strategic objectives; anticipated availability of nuclear waste storage facilities; projections of nuclear decommissioning costs; and impacts of pending litigation and various administrative orders which have been or may be issued.

Although TVA believes that the assumptions underlying the forward-looking statements are reasonable, TVA does not guarantee the accuracy of these statements. Numerous factors could cause actual results to differ materially from those in the forward-looking statements. These factors include, among other things, new laws, regulations, and administrative orders, especially those related to the restructuring of the electric power industry and various environmental matters; increased competition among electric utilities; legal and administrative proceedings affecting TVA; the financial and economic environment; performance of TVA's generation and transmission assets; fuel prices; demand for electricity; changes in technology; changes in the price of power; loss of any significant customers or suppliers; creditworthiness of counterparties; weather conditions and other natural phenomena; changes in accounting standards; and unforeseeable events. New factors emerge from time to time, and it is not possible for management to predict all such factors or to assess the extent to which any factor or combination of factors may impact TVA's business or cause results to differ materially from those contained in any forward-looking statement.

TVA undertakes no obligation to update any forward-looking statement to reflect developments that occur after the statement is made.



FY 2007 Budget Assumptions

Operational:

- Normal weather
- Normal hydro
- Energy sales of 174.8 TWh (up 2.1%):
- Browns Ferry Unit 1 restart – with full power by May 22, 2007, and a capacity factor of 93% for the rest of FY 2007
- Browns Ferry Unit 2 power uprate (adds ~ 110 megawatts)
- 4 nuclear fuel outages vs. 3 in FY 2006
- Fossil equivalent availability factor – 86.0%
- Nuclear net capacity factor – 88.4%
- Conventional hydro equivalent availability factor – 93.0%



FY 2007 Budget Assumptions

Financial:

- Fuel cost adjustment clause (FCA) in place effective on October 1, 2006
- Target a firm rate reduction of 4.0% to 5.0%
- Total financing obligation (TFO) reduction of \$529 million
- Liquidity balance target of \$500 million cash
- Target an interest coverage ratio of 2.4 times
- Target a debt service coverage ratio of 1.4 times
- Average interest rates on the debt portfolio are expected to increase approximately 0.10%
- Productivity target that holds growth in non-fuel cash operating costs to be less than or equal to expected growth in sales
 - Provides for three items to be excluded as incremental, new work scope items as follows:
 1. Operation of Browns Ferry Unit 1 for 4 months – (\$19 million)
 2. Reagents and catalysts for new clear air equipment – (\$25 million)
 3. New generation study – (\$20 million)
- Includes a management challenge of \$53 million (\$49 million in operating cost and \$4 million in capital costs)

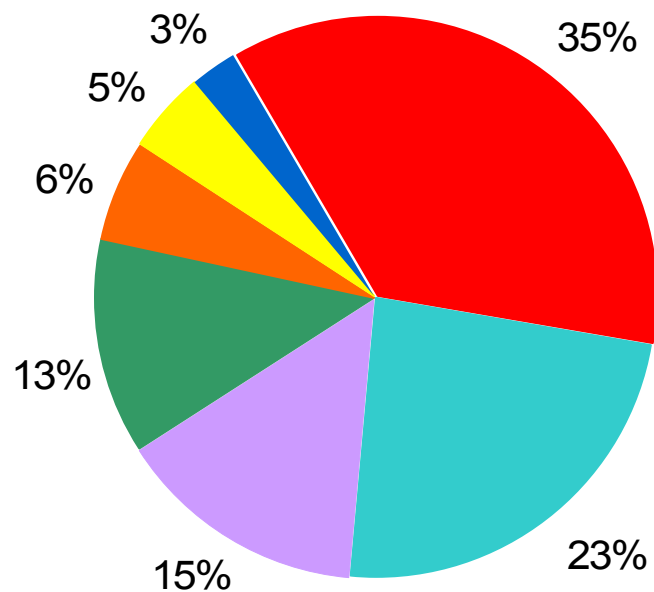


FY 2007 Cash Uses

FY 2007 Cash Uses

(in millions)

% Distribution based on 4.5% rate reduction



Cash Fuel & Purchased Power	\$3,379
Non-Fuel Cash O&M*	\$2,183
Cash Interest Expense	\$1,355
Capital Projects	\$1,122 - \$1,212
Reduction in Total Fin. Obligations	\$529
In Lieu of Tax Payments	\$439
Other Cash Costs	\$268
Total Cash Uses	\$9,275 – \$9,365

* Non-cash items excluded from O&M include emission allowance expense, bad debt expense, and non-cash portions of pension, post-retirement, and lease expenses. Total O&M expense including these non-cash items amounts to \$2,405 million.

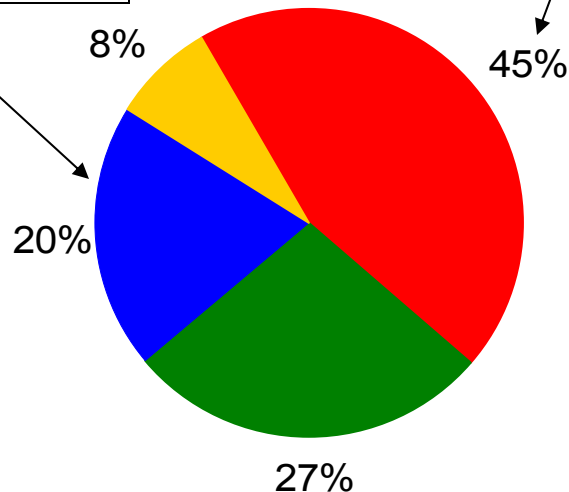


FY 2007 Capital Projects

Growth Capital:

Browns Ferry Unit 1	\$81
Other New Generation	73
Economic	60
Commitment	<u>21</u>
Total	\$234

Maintenance capital represents projects to preserve and prolong the use of current long-lived assets.



(in millions)

■ Maintenance \$ 523

■ Regulatory Compliance \$ 320

■ Growth \$ 234

■ Future Generation \$ 45 - 135

Total \$ 1,122 - \$1,212

% Distribution based on 4.5% rate reduction

Regulatory:

Clean Air	\$286
Safety	10
Regulatory	<u>23</u>
Total	\$320



Income Statement Forecast

(Millions of Dollars)

	<u>2004 Actual</u>	<u>2005 Actual</u>	<u>2006 Expected</u>	<u>2007 Pro Forma</u>
Revenue	\$ 7,520	\$ 7,771	\$ 8,988	\$9,275 - \$9,365
Operating Expenses				
Fuel & Purchased Power	(2,093)	(2,599)	(3,205)	(3,262)
Gross Margin Percentage	72.2%	66.6%	64.3%	64.8% - 65.2%
Operating, Maintenance & Other	(2,330)	(2,400)	(2,405)	(2,405)
Depreciation & Amortization	(1,118)	(1,127)	(1,500)	(1,423)
Tax Equivalents	(338)	(365)	(375)	(439)
Total Operating Expenses	<u>(5,879)</u>	<u>(6,491)</u>	<u>(7,485)</u>	<u>(7,529)</u>
Operating Income	1,641	1,280	1,503	1,746 - 1,836
Operating Margin Percentage	21.8%	16.5%	16.7%	18.8% - 19.6%
Other Income	61	60	82	36
Interest Expense (net)	<u>(1,305)</u>	<u>(1,242)</u>	<u>(1,234)</u>	<u>(1,273)</u>
Net Income	<u>\$ 397</u>	<u>\$ 98</u>	<u>\$ 351</u>	<u>\$509 - \$599</u>



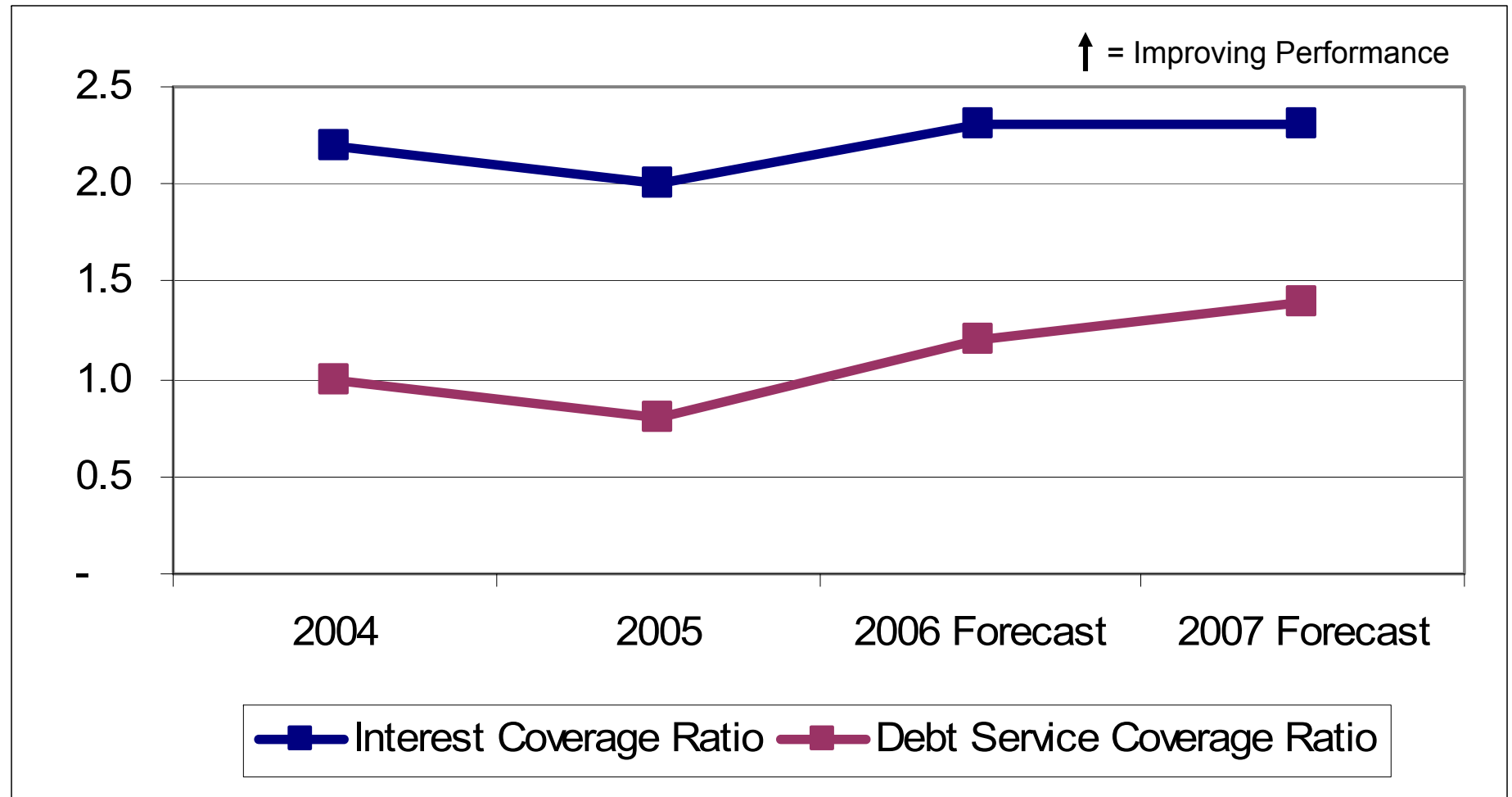
Cash Flow Forecast

(Millions of Dollars)

	<u>2004 Actual</u>	<u>2005 Actual</u>	<u>2006 Expected</u>	<u>2007 Pro Forma</u>
Sources:				
Cash from Operations	\$1,785	\$1,452	\$1,951	\$2,022 - \$2,112
Uses:				
Capital Projects	(1,041)	(1,020)	(1,057)	(791)
Clean Air Projects	(411)	(202)	(201)	(286)
Future Generation	-	-	-	(45) – (135)
Total Capital Projects	(1,452)	(1,222)	(1,258)	(1,122) – (1,212)
Nuclear Fuel	(118)	(141)	(276)	(268)
Other Sources/(Uses)	89	267	(30)	(29)
Payments to U.S. Treasury	(38)	(36)	(38)	(38)
Change in Total Fin. Oblig.	(279)	(301)	(340)	(529)
Total Uses	<u><u>(1,798)</u></u>	<u><u>(1,433)</u></u>	<u><u>(1,942)</u></u>	<u><u>(1,986) – (2,076)</u></u>
Change in Cash	<u><u>\$ (13)</u></u>	<u><u>\$ 19</u></u>	<u><u>\$ 9</u></u>	<u><u>\$ 36</u></u>



Trend of Interest Coverage Ratio & Debt Service Coverage Ratio

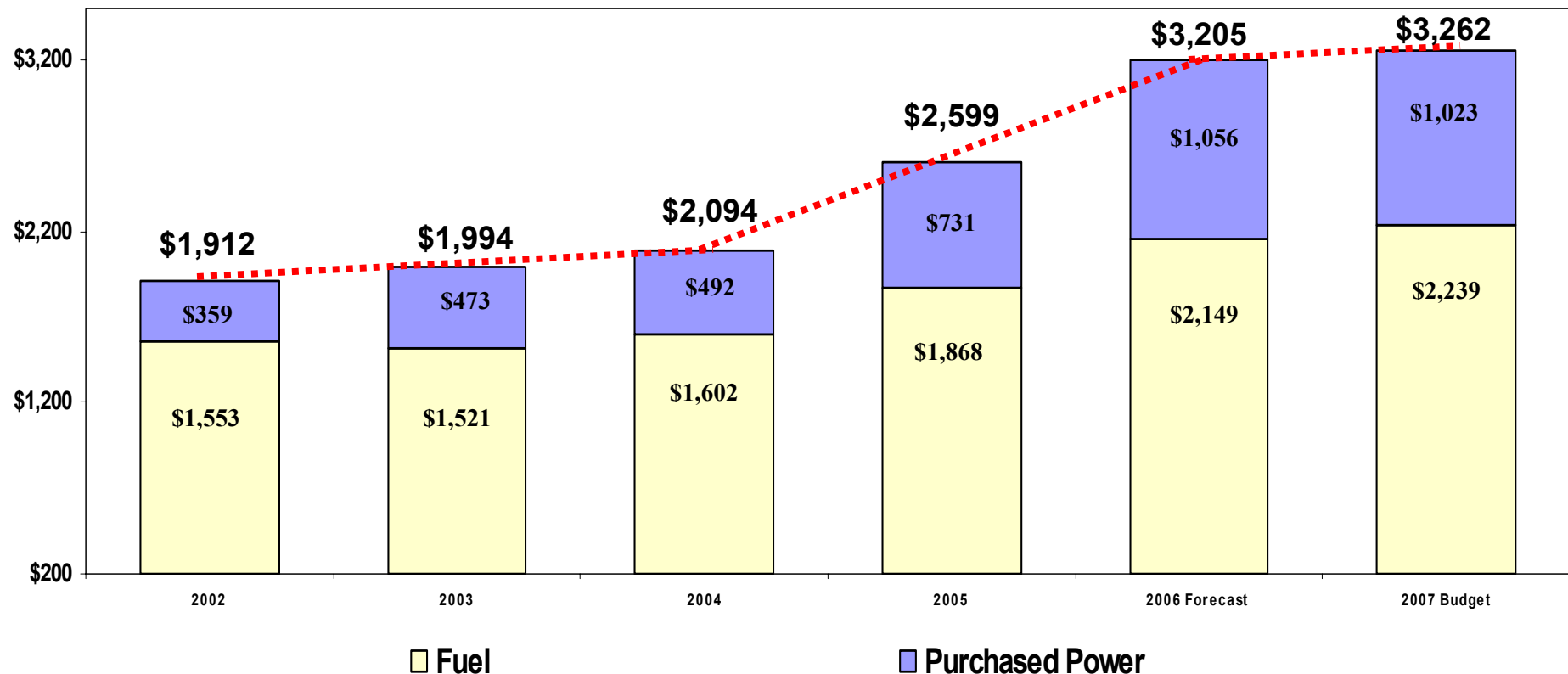




Fuel & Purchased Power Expense

Current forecast for FY 2007 now reflects a more moderate increase from the FY 2006 forecast reflecting the Browns Ferry Unit 1 restart.

(in millions)





Proposed Fuel Cost Adjustment

- Allows for more timely recovery of volatile fuel and purchased power costs through quarterly rate adjustments.
- Methodology has been jointly developed by TVA staff and customers over the past 12 months.
- The FCA starts at zero in the first quarter of the fiscal year.
- Fuel cost adjustment is a key determinant used by rating agencies. Most of investor-owned utilities surrounding TVA have similar mechanisms already in place. Many if not all of TVA's gas distributor customers use an adjustment mechanism to recover or rebate changes in gas prices.
- Recommended for implementation effective on October 1, 2006.
- First potential FCA adjustment is January 1, 2007. Quarter 1 (October, November, December) FCA forecast will be equal to budget.



Fuel Cost Adjustment Mechanism

- The FCA will be set on a baseline (approved FY 2007 budget) for fuel and purchased power cost included in base revenue requirements.
- The FCA includes only the direct cost of fuel used in TVA's generating plants and other fuel-related costs directly dependent upon the level of electricity generation and the energy cost of purchased power.
- Prior to each quarter, an FCA rate adjustment will be made (upward or downward) to reflect the forecasted difference from the baseline. The FCA will only be applied to energy charges from the firm power rate schedules.
- Differences between forecasted and actual FCA costs will be captured in a balance sheet deferred account. Each quarter, half of the deferred account balance will be included as a part of the total FCA calculation for the next quarter.
- At least quarterly, we will communicate to our customers a comparison of our actual costs to our forecasted costs. Additionally, each quarter we will provide updates on the FCA forecast.
- The FCA contemplates a dispute process for customers to communicate concerns up through management and potentially to the Board for consideration.



FY 2007 Budget Recommendation

- This budget proposal for FY 2007 achieves the following results:
 - A productivity target that challenges the staff to hold growth in Non-Fuel Cash O&M spend to be less than or equal to the expected growth in sales, including a management challenge
 - TFO reduction of \$529 million
 - Maintain cash balance target at \$500 million throughout the year for liquidity
 - A fuel cost adjustment clause (FCA) effective on October 1, 2006
 - A firm rate reduction of 4.0% to 5.0% effective on October 1, 2006